



Treasury

ED 305 sub 1

Contact: Sean Osborn  
Telephone: (02) 9228 5932

Dr Keith Kendall  
Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins Street West  
VIC 8007 Australia

Dear Dr Kendall

*Keith*

**Exposure Draft 305 *Lease Liability in a Sale and Leaseback***

The Heads of Treasuries Accounting and Reporting Advisory Committee (HOTARAC) welcomes the opportunity to respond to ED 305 *Lease Liability in a Sale and Leaseback*. HOTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises the senior accounting policy representatives from all Australian states and territories and the Australian Government.

The attachment to this letter sets out HOTARAC's response to the specific matters for comment. Overall, HOTARAC does not support ED 305. The proposed requirement to incorporate estimated variable lease payments in the initial measurement of lease liabilities and Right of Use (ROU) assets from sale and leaseback transactions (as specified in AASB16.100A) is inconsistent with measurement requirements for leases in general.

If you have any queries regarding HOTARAC's comments, please contact Vincent Padgham from the Commonwealth Department of Finance on (02) 6215 1927 or by email to [vincent.padgham@finance.gov.au](mailto:vincent.padgham@finance.gov.au).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Stewart Walters'.

Stewart Walters  
CHAIR  
Heads of Treasuries Accounting and Reporting Advisory Committee  
15 February 2021

**ENCLOSED:**

HoTARAC Comments to the AASB on ED305

## Attachment

**Question 1—Measurement of the right-of-use asset and lease liability arising in a sale and leaseback transaction (paragraphs 100(a)(i), 100A and 102B of the [Draft] amendment to IFRS 16)**

The [Draft] amendment to IFRS 16 Leases applies to sale and leaseback transactions in which, applying paragraph 99 of IFRS 16, the transfer of the asset satisfies the requirements to be accounted for as a sale of the asset. The [Draft] amendment proposes:

- (a) to require a seller-lessee to determine the initial measurement of the right-of use asset by comparing the present value of the expected lease payments, discounted using the rate specified in paragraph 26 of IFRS 16, to the fair value of the asset sold (paragraph 100(a)(i));
- (b) to specify the payments that comprise the expected lease payments for sale and leaseback transactions (paragraph 100A); and
- (c) to specify how a seller-lessee subsequently measures the lease liability arising in a sale and leaseback transaction (paragraph 102B).

**Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.**

HoTARAC response: The requirement to incorporate estimated variable lease payments in the initial measurement of lease liabilities and ROU assets from sales and leaseback transactions (as specified in AASB16.100A) is inconsistent with measurement requirements for leases in general. This will be confusing and lead to leases with equivalent terms being accounted for differently. Some public sector sale and leaseback leases have long terms, for which estimation of future variable payments would be difficult.

**Question 2—Transition (paragraph C20E of the [Draft] amendment to IFRS 16)**  
Paragraph C20E of the [Draft] amendment to IFRS 16 proposes that a seller-lessee apply the [Draft] amendment to IFRS 16 retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to sale and leaseback transactions entered into after the date of initial application of IFRS 16. However, if retrospective application to a sale and leaseback transaction that includes variable lease payments is possible only with the use of hindsight, the seller-lessee would determine the expected lease payments for that transaction at the beginning of the annual reporting period in which it first applies the amendment.

**Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.**

HoTARAC response: The proposed transitional implementation arrangements for sale and leaseback transactions in Appendix C seem confusing. For example, when wouldn't hindsight be required in retrospectively determining variable lease payments? Retrospective application back to the AASB 16 transition date would also be difficult, given that ED 305 may not become effective for some time.



Australian Accounting Standards Board  
via email: [standard@asb.gov.au](mailto:standard@asb.gov.au)

19 February 2021

**Defence Housing Australia Response: Exposure Draft – ED 305 Lease Liability in a Sale and Leaseback - December 2020**

Defence Housing Australia (DHA) welcomes the opportunity to submit its views to the Australian Accounting Standards Board (AASB) regarding Exposure Draft (ED) 305 *Lease Liability in a Sale and Leaseback*.

DHA is an Australian Government Business Enterprise whose primary objective is to provide housing to Australian Defence Force members and their families. In order to achieve this objective, DHA manages a portfolio of approximately 18,000 properties, utilising a number of property provisioning methods including direct ownership and leasing alternatives. DHA's portfolio comprises approximately 5,000 owned properties and DHA is party to approximately 13,000 property leases.

The majority of leases were entered into via a Sale and Leaseback (SLB) arrangement with long terms. Lease terms are typically 12 years plus a further 3 year option. Many leases will be extended beyond these initial terms.

DHA regularly enters into new lease arrangements—during the 2019/20 financial year, DHA entered into 756 property leases of which 330 were from SLB transactions and, for the 6 months ended 31 December 2020, DHA entered into 429 residential property leases, of which 114 were from SLB transactions.

As at 30 June 2020, the carrying value of DHA's lease liabilities totalled \$1.645 billion. DHA maintains Lease Liabilities which reflect current market values by undertaking an annual independent market rent valuation, with rental for the following 12 months then aligned to valuation outcomes, with consequent re-measurement of Lease Liability values.

DHA has detailed its views below in relation to each of the matters raised by the AASB and has included, for reference, its draft comments in relation to the questions raised by the IASB.

DHA would welcome discussion of this submission—should you wish to do so, please do not hesitate to contact Graham Arundel ([graham.arundel@dha.gov.au](mailto:graham.arundel@dha.gov.au)) or myself ([paul.groenewegen@dha.gov.au](mailto:paul.groenewegen@dha.gov.au)).

Yours sincerely

Paul Groenewegen  
Chief Financial Officer  
Defence Housing Australia



## **Defence Housing Australia**

### **Response to Exposure Draft 305: Lease Liability in a Sale And Leaseback**

**December 2020**

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#### **AASB Matter:**

*Whether there are any regulatory issues or other arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:*

- *Not-for-profit entities; and*
- *Public sector entities, including GAAP/GFS implications*

#### **DHA Response:**

DHA has not identified any regulatory or other issues that may affect the implementation of the proposal.

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#### **AASB Matter:**

*Whether the proposal would create any auditing or assurance challenges;*

#### **DHA Response:**

DHA's view is that this proposal would result in significant auditing and assurance challenges. Challenge arises from a lack of high quality information to be used as a reference base when reviewing the long range property market movement forecasts underpinning lease liabilities, as proposed by ED 305.

#### **Rationale**

Reliable sources of appropriate rental growth forecasts that would assist DHA to determine the expected payments for the 15 year term (or longer) of a lease incepted via an SLB transaction are presently not available in the market. Reviewing the basis of the forecasts for assurance purposes would be a challenging and complex task for auditors.

A paucity of externally available information supporting forecasts would lead to added audit complexity, cost and assurance risk, heightened especially by the length of time and the extent of uncertainty surrounding the required forecast. DHA is concerned that the accuracy and reliability of lease liabilities of significance to the financial statements would come into question because of a necessary reliance on a potentially poor information base to formulate long range forecasts.

Australian Auditing Standard (ASA) 540 notes that financial reporting frameworks often call for neutrality - that is, freedom from bias. Estimation uncertainty gives rise to subjectivity in making an accounting estimate and a potentially poor evidence base supporting long term forecasts carries heightened risk of management



bias – possibly to create a desired profit result or capital ratio - and, at the same time, a more difficult audit evaluation as to whether management bias exists.

Further, the ED 305 proposal that variances between the actual rental payment and the forecast amount be recognised through profit and loss means that any bias present would only be unwound over the term of the lease.

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**AASB Matter:**

*Whether overall, the proposal would result in financial statements that would be useful to users;*

**DHA Response:**

DHA's view is that the proposal will not result in financial statements that would be more useful to users of financial statements. Rather the proposals could lead to a deterioration in comparability and usefulness due to differential treatment of equivalent leases relating to the same type of underlying asset.

**Rationale**

Were the ED305 proposals to apply, DHA would need to discriminate between the treatment of its property leases on the basis of whether the lease incepted through a SLB or by other arrangement, leading to the application of different measurement methods despite the arrangements being equivalent in the lease terms, administration and underlying asset.

AASB16 BC166 references the IASB's view that forecasting changes in an index or rate requiring macroeconomic information that may not readily be available to all entities may result in measurement uncertainty.

As noted above, the requirement to estimate expected payments in order to determine the lease liability for SLB leases would require DHA to determine long term forecasts of future movements in the residential property market and that there is a paucity of reliable information to support the determination of such forecasts.

To the extent that the necessary long range forecasts are subject to measurement uncertainty, recognition of variance could be expected to grow in significance in the lease accounting disclosures, reflecting the impact of a potentially poor assumption setting process rather than business operating outcomes.

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**AASB Matter:**

*Whether the proposals are in the best interest of the Australian Economy be more useful to users of financial statements.*

**DHA Response:**

DHA does not have a view on whether this would be in the best interests of the Australian Economy.

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**AASB Matter:**

*Unless already provided in response to specific matters for comment 1 – 4, the costs and benefits of the proposal relative to the current requirements, whether quantitative (financial and non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature and estimated amounts of any expected incremental costs, or cost savings, of the proposal relative to the existing requirements.*

**DHA Response:**

DHA's view is that the costs associated with the proposed changes outweigh any potential benefit that the users of the Financial Statements may obtain.

**Rationale**

Due to the nature of DHA's business and number of leases involved, DHA invested significant resources in developing a lease accounting system to apply the complex (in DHA's case) requirements of *ASSB 16: Leases*. Accounting for the 13,500 individual leases active at some time in the 2019/20 financial year involved processing of 2.2 million AASB 16: Leases related journal lines.

Were the proposed changes of ED 305 to be adopted, DHA would be required to invest further significant resources to re-measure SLB leases on an historical and ongoing basis.

DHA also views the proposals as introducing, in its circumstances, additional assurance risk, with commensurate ongoing additional audit cost.

DHA believes the cost of implementation and ongoing application of the ED 305 proposals outweighs any potential benefit as DHA notes the potential for deterioration in usefulness of the financial statements.



## Draft DHA Responses to International Accounting Standard Board Questions

### **IASB Question 1: Measurement of the right-of-use asset and lease liability arising in a sale and leaseback transaction (paragraphs 100(a)(i), 100A and 102B of the [Draft] amendment to IFRS 16)**

*The [Draft] amendment to IFRS 16 Leases applies to sale and leaseback transactions in which, applying paragraph 99 of IFRS 16, the transfer of the asset satisfies the requirements to be accounted for as a sale of the asset. The [Draft] amendment proposes:*

- (a) to require a seller-lessee to determine the initial measurement of the right-of-use asset by comparing the present value of the expected lease payments, discounted using the rate specified in paragraph 26 of IFRS 16 to the fair value of the asset sold (paragraph 100(a)(i));*
- (b) to specify the payments that comprise the expected lease payments for sale and leaseback transactions (paragraph 100A); and*
- (c) to specify how a seller-lessee subsequently measures the lease liability arising in a sale and leaseback transaction (paragraph 102B).*

*Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.*

#### **DHA Response:**

DHA does not agree with the proposal at question 1.

The proposed approach would result in inconsistent treatment of leases due to different measurement techniques being applied to leases obtained either from an SLB arrangement or by other means, despite there being the same underlying assets (in DHA's case, residential property). The divergence in measurement methods would lead to confusion for users of the financial statements, as DHA currently bases values for all leases—SLB leases and other direct leases—to movements in the residential property market.

The proposed changes would also add complexity to DHA's accounting systems and processes and create an additional burden of administrative effort and cost in order to comply with the proposed standard.

#### **Rationale**

Under the proposed changes outlined in ED 305, DHA would need to amend the measurement requirements for leases originating from SLB transactions to factor forecast movements in the rental market in order to determine the expected payments of the lease. For other leases (i.e. not originating from an SLB) this amendment would not be conducted even though it is the same underlying asset. Current DHA process is that all DHA property leases are subject to a market rent revaluation on 31 December each year. Rental for the following 12 months is then aligned to the third party market rental valuation.

Lease payments within DHA leases meet the definition of a variable lease payment as defined by AASB 16 Leases appendix A. Therefore, DHA currently measures the lease liability on commencement in accordance with AASB 16.27(b) and determines the future lease payments based on the current market rent at the time the lease is executed. No allowance is made for expected movement in the property rental markets. DHA also utilises the current market rent, at lease commencement, when measuring the right of use asset as a



proportion of the carrying amount that relates to the rights retained as outlined in AASB16.100 for a lease originating from an SLB transaction.

The requirement to estimate expected payments in order to determine the lease liability for SLB leases would require DHA to forecast future movements in the residential property market. The majority of SLB leases are 15 plus years in length and forecasting property rental markets would be problematic. Any variance from expected lease payments compared to the actuals would be recognised in profit or loss at the time the variance occurs in accordance with AASB16.38. DHA is of the view that since some forecasts could have been made 15 years earlier, the impact on profit and loss due to AASB16.38 would lead to misleading financial statements and confusion for the users.

#### Alternative proposal

DHA is of the view that the requirements of AASB 16.42(b) that the lease liability needs to be restated when there is a change in lease payments resulting from a change in market rentals, provides the user of the financial statements with a more consistent source of information for all leases that are linked to market movements regardless of the origins of the lease.

DHA acknowledges that more guidance is required for the measurement of lease liabilities for leases which are purely linked to rates or indexes. DHA however does not agree to the proposed measurement requirements outlined in ED 305 for leases that have variable lease payments that change to reflect movements in market rentals.

DHA recommends that proposed paragraph 100A(b) be amended to exclude variable payments that change due to changes in market rentals. DHA is of the view that there is sufficient guidance contained within paragraph 27 of AASB 16 to determine the lease liability at commencement date for leases with market rental adjustments contained within the lease.

#### **IASB Question 2: Transition (paragraph C20E of the [Draft] amendment to IFRS 16)**

*Paragraph C20E of the [Draft] amendment to IFRS 16 proposes that a seller-lessee apply the [Draft amendment to IFRS 16 retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to sale and leaseback transactions entered into after the date of initial application of IFRS 16. However, if retrospective application to a sale and leaseback transaction that includes variable lease payments is possible only with the use of hindsight, the seller-lessee would determine the expected lease payments for that transaction at the beginning of the annual reporting period in which it first applies the amendment.*

*Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.*

#### **DHA Response:**

DHA does not agree with the proposal at question 2.

The proposed change adds unnecessary complexity and would require further significant investment in systems and an administrative burden to restate prior year financial statements with little benefit for users of the financial statements.





### Rationale

ED 305 proposes that the seller-lessee apply the amendments to AASB 16 retrospectively for sale and lease back transactions entered into after the date of initial application, in accordance with AASB 108. AASB 16.27 already requires entities to use market rent on commencement of a lease when determining the lease liability and there is no benefit in requiring an entity to restate prior financial year general purpose financial statements to factor in expected growth in rental payments. AASB 16.42(b) already requires that DHA restate the lease liability based on actual movements within the residential property market, and therefore DHA is of the view that this provides more reliable information to the users of the financial statements.

The complexity and administrative burden associated with the requirement to complete a full retrospective adjustment would be significant for DHA. DHA is of the view that it will not provide the users of financial statements with further benefit or clarity as SLB leases are linked to movements in market rents and the initial lease liability has already been calculated using the market rent on the commencement date of the lease.

### Alternative proposal

Should the proposed amendments be accepted, DHA suggests that an alternative method be provided for SLB leases which are linked to rental market movements, and change to the measurement requirements only for leases that commence after the amendment is effective.

